Paving the Way Forward for Rural Finance
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Case Study

Rural Financial Institutions:
Restructuring and Post Restructure Results

The Agricultural Bank of Mongolia: From Insolvent State Bank to Thriving Private Bank

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Introduction

The Agricultural Bank of Mongolia (Ag Bank) is the main provider of financial services in the rural areas of Mongolia. It has the largest branch network in the country with 356 locations and provides deposit and loan products in each location. Although in receivership in 1999 and facing possible liquidation, this former state bank has been completely turned around and was privatized through international tender to a major Japanese company in March 2003. Turnaround efforts have resulted in the Bank's disbursing more than 500,000 loans to date while maintaining an arrears rate consistently below 1 percent and becoming the second most profitable bank in Mongolia.

This turnaround identified and mobilized the strengths of an existing institution to rapidly disseminate desperately needed financial services to the rural areas as well as protect access to the few existing financial services that many rural Mongolians already relied upon.

After many years of operating deficits, loan losses, and a failed attempt at privatization, the Ag Bank was placed in receivership in 1999, and many in the international community felt that it could never operate sustainably on its own and should be closed down. Yet the importance of the Ag Bank to Mongolia's rural sector could not be overstated. Although it was one of the smaller financial institutions in the country, it was the only bank with branches throughout Mongolia's vast territory to transfer money, make government pension and salary payments, and accept deposits. Closing it would have had a devastating impact on the rural economy.

The World Bank made reforming the Bank a condition of its Financial Sector Adjustment Credit Program for Mongolia, and USAID agreed to provide funds for an outside management contract. The Government of Mongolia agreed to provide this outside manager with the full authority to manage the institution free from political or other interference.

A contract was signed with Development Alternatives, Inc. (DAI) of Bethesda, Maryland, to manage the Bank. In July 2000, a team led by J. Peter Morrow, Chief Executive Officer, and Debra Boyer, Chief Operating Officer, arrived in Mongolia to manage the Bank on a full-time basis. DAI home office staff provided technical support as the team set the agenda for the turnaround. Various short-term technical advisors through DAI provided support during the transformation.

By agreement among all parties, the mission of the turnaround was to:

1. Restore financial soundness to the Bank;
2. Bring financial services to the country's rural population; and
3. Prepare the Bank to operate independently and be privatized.

In January 2003, the efforts of the many parties involved were realized as the Government of Mongolia received three viable bids for the Bank, all from strong and fully qualified private sector buyers. H.S. Securities of Japan was the highest bidder and at $6.85 million became the successful purchaser of the Bank. The sale closed on March 25, 2003. The new owners have hired DAI to continue to provide management to the Bank.

Ag Bank's current mission statement is:

> *"To be the principal nationwide financial services company in Mongolia by delivering first class products with the highest level of customer service."*

The rural areas of Mongolia have been the Bank's main focus and its successes there have laid the foundation for substantial growth and new services for all Mongolians. Key to the turnaround of the institution was developing and implementing products throughout the country profitably. The Ag Bank has shown that products can be created and delivered in even scarcely populated areas if they truly meet the needs of customers.

The institution has now proven that it can sustain itself and, in fact, contribute significantly to Mongolia's overall economic development. Aside from the large impact of its loan and deposit activity, the opening of 87 new branches and creation of 700 good paying jobs boosted the economies of many communities. In addition, the Ag Bank is now one of the largest taxpayers in Mongolia where before it was a cash drain on the government.

RESULTS AND IMPACT

Ag Bank operates a network throughout Mongolia, much greater than any of the other 16 banks in Mongolia. Through such a network, the Bank reaches 98 percent of the rural communities in Mongolia.

The results from these new products and other restructuring initiatives have been impressive. Some of the startling statistics for the period July 2000 to December 2002 are:

- Banking offices grew from 269 to 356;
- Number of employees increased from 803 to 1,525;
- One out of every two rural households used Ag Bank;
- More than 400,000 loans were made with a repayment rate of 99 percent;
- Loan sizes averaged $210;
- Ninety percent of all lending was made in rural areas, across different population sectors;
- Deposits grew from $9 to $39 million;
- Monthly pre-tax profits grew from a loss to an average of $250,000; and
- The Bank paid $1.7 million in income taxes in 2001 and 2002, combined.

The management team developed a new lending program, converted payment services into deposits, created an extensive marketing program to increase deposits, implemented strong controls through new policies and procedures, created a more effective management structure, and significantly increased training activities.

Microenterprise loans, small and medium-sized enterprise (SME) loans, crop and herder credits, and pension and salaried based loans have been created and implemented. Individuals who would not qualify for the Bank's small business loans often use a consumer loan to get started in a new venture. Ag Bank has created a new class of borrowers. By recognizing the informal lending sector as a real competitor, many borrowers have successfully moved into the formal financial system. Ag Bank's branches are quickly replacing pawnshops, store owners, and relatives for business and consumer borrowers. As of the end of December 2002, 400,000 loans were disbursed and the Bank celebrated its 500,000th loan disbursed in April 2003.

Another example of an important change has been the conversion of 200,000 government social security and salary payments into deposit accounts. Experience at Ag Bank shows that one-third of all government payments made through a deposit account stay in the account for an extended period. This conversion brought more deposits to the Bank and helped build relationships with new customers who could then take advantage of other Bank services and loans. Once accounts are open, the public can access alternative payment systems.

Money also has moved out from under mattresses as individual deposits have grown from $2.5 million to $27 million between December 2000 and December 2002. Most new depositors are people who were not previously depositors in banks.

Ag Bank's aggressive increase of deposits and loans, and a subsequent expansion of other banks' operations throughout Mongolia, has had an impact on the intermediation of Mongolia's money supply. In the year 2000, more than half the country's money supply was in the form of currency outside banks; today less that one-third is held as currency. The long-term benefit of this intermediation for Mongolia's development is considerable.

Another measure of the Bank's impact is the growth in the small businesses that dominate rural Mongolia. Average small business loan sizes have increased steadily over the past two years as increased inventory levels have translated into increased sales.

Products include loans, deposits, domestic and international transfer products, and government payment services. The client market consists of government organizations, small businesses, and consumers.

Ag Bank's History

The Bank was actually founded as the "Agricultural Cooperative Bank" in 1991. It was formed when agricultural cooperatives, herdsman, and farmers put together an initiative to establish a bank to serve the agricultural sector. At establishment, the Bank inherited a huge structure of 326 branches and settlement centers with 2,600 employees. There were demand deposits of MNT 2.2 billion and loan debts of MNT 2.3 billion. Although the Bank was paying interest on the deposits at a rate determined by the Central Bank, the loan portfolio was not generating interest income. The portfolio thus became a passive asset that became a drain on the Bank and eventually led to large losses.

After a few years, the agricultural cooperatives and farms were privatized into numerous small entities. In 1992, the deterioration of the Bank's business and movement toward a market economy forced a reorganization of the institution. The Bank expanded lending to larger loans through government interference. Services were widened to state administrative and budgetary organizations and the infrastructure sector.

However, by 1996, the Bank's liquidity and financial position deteriorated to a level where the Central Bank appointed a receiver. The problem was primarily attributed to the inherited loan portfolio. From financing from the Asian Development Bank (ADB), the Government of Mongolia placed government bonds into the institution to replace the inherited bad loans.

In 1999, poor management led to continuing problems as both the banking operations and loan portfolio continued to deteriorate. After the Bank was put into receivership, existing shareholders' interests were eliminated, and a Restructuring Plan was put together by the Central Bank. The government became the new sole owner through a capital infusion via Government Restructuring Bonds, converting debt to equity, and through injections of cash.

Thus, since the Bank's beginning in 1991, it had been fraught with troubles because of poor management and irresponsible lending. Because the government had recapitalized the Bank to cover years of losses, it was critical that a new image be created under new management to break the perception in the market that the Ag Bank had established.

Loan and Deposit Summary

Table 1: Loans (as of December 31, 2002)

Loan Product	Date Product Launched	Total Number of Loans Disbursed	Total Value of Loans Disbursed ($000s)	Total Number of Loans Outstanding	Total Value of Loans Outstanding ($000s)
Small Business	Nov. 2000	49,389	57,452	11,172	14,080
Pensioners	May 2001	286,420	15,955	47,497	2,803
Herders	Aug. 2001	10,034	8,332	3,081	2,874
Payroll Based	Oct. 2001	52,537	11,346	21,956	4,160
Other	2001/2002	3,298	3,140	892	1,076
Total		401,678	96,225	84,598	24,993

Note: *All loans are made in the local currency, tugrug, but are converted here to U.S. dollars.*

Table 2: Deposits (converted to $000s)

Deposit Category	12/31/02		12/31/01		12/31/00	
Business entities	9,798	22%	8,117	33%	3,663	28%
Individuals	27,028	60%	7,752	32%	2,520	20%
Government organizations	8,207	18%	8,570	35%	6,712	52%
Total	45,034		24,439		12,896	

Loan Strategy

The strategy has been to develop products that meet the needs of a large segment of the market, ensuring diversification by product and by geographical area. The idea from the beginning was to quickly pilot products and then to expand the delivery throughout locations countrywide rapidly. A focus on conservative lending has always been maintained. This differs from the strategy of similar efforts of moving more slowly and focusing on quick saturation at each branch. All products were designed to be integrated into the branches by the existing staffs that are responsible for delivering a wide array of products. This ensures that the right products weigh properly in each market.

Mongolia has 21 *aimags* that have acted as regional hubs. The focus was on training at the *aimag* level and then the *aimag* would train the rural locations that report into that hub. Thus, a fast and efficient way of disseminating new products and other communication was developed.

Each *aimag* center branch manager comes to the head office in Ulaan Baatar once a quarter and is given a substantial amount of one-to-one time with the senior management of the Bank. Targets are made quarterly for lending and deposit generation. Any administrative issues are handled at that time as well. Thus, the targets are set mutually between the regional areas and the home office so that they are realistic yet meet the overall strategies of the Bank.

Incentive payments have been a critical part of the success of the institution. Every employee receives incentive compensation on a quarterly basis that is a significant percentage of his or her salary. For those employees with ties to lending operations, they are highly motivated to generate high loan volumes and maintain quality portfolios.

Summary of Loan Products

Small Business Loans. The original product launched in November 2000 was called the "small traders loan." In 2001, the "small business loan" evolved from it as the market for the product was widened. It now includes small service, production, and mixed purpose businesses—essentially any kind of small business. This short-term working capital loan is the mainstay of the lending program and is marketed to all creditworthy clients in all markets. Current interest rates are 3 to 4 percent per month, but are coming down because of competitive factors and because the costs of underwriting are decreasing with economies of scale.

SME Loans. This product was developed for medium-sized production companies. Because these loans are larger in size and term, they are inherently more risky. They are being made on a limited basis now as the lending team for SME loans is trained and the products are tested in the market. A significant expansion of this product is expected in 2003.

Pensioner Loans. Pensioners were coming into the Bank branches on a monthly basis to withdraw their payments. This market was clearly underserved for loans. As well, there were enormous transactions costs with paying so many small pensions per month. As part of the pension disbursement reform effort in 2001, a loan product was developed for this market. These small loans, which can be up to six times a pensioner's monthly payment, are repayable by assignment and automatic deduction from future pension payments. These loans empower pensioners to control their cash flow and are an alternative to their current borrowing from pawnshops and the informal sector. It assists the pensioners in acquiring more household assets as opposed to all of their funds getting mixed into family operating expenses. As well, pensioners are able to borrow money to help their family members venture into microbusiness activities.

Herder Loans. These loans were specifically designed to meet some of the unique needs of Mongolians based on cultural and business differences. Available on terms of up to one year, they help cover the gap between living and operating expenses in the months when herders are not generating income or wish to purchase herd-related goods. Because herders have substantial cash at certain times of the year, penetration of the herder market with comprehensive training and banking services is a priority.

Payroll Loans. Borrowers can borrow up to seven times their monthly salary for a variety of purposes for a term up to one year. Loan payments are made directly through a deduction from their regular salary. These loans provide significant cross-marketing opportunities because employers get multiple requests employees for this service. Employers realize that the Bank can handle their entire payroll under a blanket agreement saving on administrative costs and, thus, bringing employer deposits and fees to the Bank.

Agricultural Production Loans. These loans were introduced in spring 2002 and piloted in four regional areas. Interest is primarily from vegetable growers, small private wheat farmers, and hay producers.

Deposit Strategy

The strategy since DAI took over management of the Bank in 2000 has been threefold: (1) to increase the deposit base to fund the Bank's growth, (2) to attract a large and diverse number of customers (business and consumer) to solidify the Bank's franchise and strengthen the network, and (3) to lessen the dependence on government sources of funds.

By creating products that meet the needs of the market and providing good customer service, the Bank has been able to increase its deposit base more than 400 percent since July 2000. This growth has in turn propelled the growth of the Bank: it is now the fourth largest bank in Mongolia based on asset size. The percentage of deposits from the government has dropped from 52 percent at the end of December 2000 to 18 percent at the end of December 2002.

By providing good service and not charging withdrawal fees, the Bank is building solid relationships with its clients. Because of this confidence, depositors are more likely to leave their money in the Bank for longer periods of time. All deposit products are offered in the local currency, tugrug, or U.S. dollars.

Summary of Deposit Products

Personal or Business Current Accounts. These accounts are designed for those making regular financial transactions and need regular statements.

Savings Accounts. Depositors may add and withdraw money at any time without fees, and the account pays interest.

Time Deposits. This product pays a higher interest rate than a savings account. Deposits are encouraged to be for at least three months, and incentives are given to savers to add to their deposits over the term.

Pension Direct Deposit. This program was contractually agreed to with the Social Insurance Fund in early 2001. This meant opening accounts for each pensioner, providing them with an additional service, and raising the deposit base of the Bank by opening hundreds of thousands of new accounts.

Payroll Direct Deposit. Similar to the pension direct deposit, this product is marketed to large employers that want to eliminate the administrative expense of paying employees in cash. In addition to increased fee income for the Bank, the Bank also benefits from the many new individual deposit accounts.

Money Transfer Products

All transfer products are available to anyone, but with reduced fees for an Ag Bank customer.

Summary of Transfer Products

Quick Pay. Key to the success of the Bank has been the franchise that has been developed throughout the country. This product guarantees fast delivery (in three hours or less) of cash transfers between offices in the capital, Ulaan Baatar, and one of the 52 regional locations in the country.

Money Transfer. The transfer of money from any Ag Bank location to any other Ag Bank location in the country. A transfer is delivered the next day if to a regional center and within three days if to a rural center.

Western Union. Money can be received at any Ag Bank location in Mongolia and funds can be sent to more than 180 countries worldwide.

CHALLENGES WITH PROJECT IMPLEMENTATION

Sustainability and Privatization

At the beginning of the management contract, the team knew that it was crucial to (1) develop the internal staff capacities, (2) develop proven products for the market, and (3) find a successful resolution to the political influence that dominated the Bank for years.

The goal was privatization. By stabilizing the institution and creating transparency, a buyer would clearly understand what was being bought. By developing and proving products and services in the market, the Bank would have the profitability to sustain itself. As a measure of success, the Bank was privatized in March 2003. Most importantly, the strength of the Bank is the rural network and product offering. Thus, it was clear that a buyer was not interested in the Bank due to the success of offering services in the rural areas. This ensures that access to those products will continue.

H.S. Securities, the buyer of the Bank, has stated that it wants to continue to expand based on the Bank's target markets. They will be investing millions of dollars more into the Bank to continue the outreach and market absorption.

From a cost recovery perspective of the original work that began in July 2000, the value of the Bank has increased so much over the period that it could have easily paid for the cost of the turnaround by the value that was created, witnessed by the sale price. The earnings this year will be relatively equal to the entire cost of the three-year turnaround.

Political Issues

Shortly after starting the project in July 2000, there was a complete change in government from the Democratic Party back to the former Communist Party. Although initially suspicious of the agreements made for Ag Bank's remediation, the new government eventually supported it fully.

Credit Culture

No bank in Mongolia had previously attempted to develop and implement a fully transparent lending program available to all who qualify. Some donors suggested that Mongolia's loan history was so bad that the Bank should be remediated without lending. However, the team felt that it was critical to make loans. Otherwise, the Bank would not recover financially or restore services to the public without providing loans. Through the appropriate design of the products described earlier and the right staff motivation, a new credit culture was developed.

Previously, most people in Mongolia have had to rely on pawnbrokers and family members for loans in the past. Thus, the lending products were truly welcome as they allowed people access to greater money and at a lower cost of funds. However, people had rarely been able to borrow from formal financial institutions. Often that lending in the past was associated with the government and there was often not pressure to repay, especially in a timely manner, thus typically there was not a culture of timely repayment among potential borrowers.

Thus, the culture had to change, both at the branch manager level and at the customer level. This challenge was met by holding the branch managers completely accountable for the decisions that they made. Absolutely zero tolerance was given to politicians locally or nationally who tried to influence the lending. Because an outside management team was running the Bank, it was easier to build this firewall.

Staff Culture

There was an opinion that the Bank had too much of a "state sector" mentality and that the staff would not be able to accept the changes necessary to turn the Bank around. However, the employees at the same time were well educated and very good at performing many day-to-day banking tasks. It was clear that a new culture could not be developed overnight but that is would be a process. The key was to harness the capabilities and skills of the staff right away and then to expand on their skills. New policies and procedures were written for all areas of the Bank, and training was developed. Because of the "state culture" to follow the rules, people caught on quickly and responded to the changes. Fully changing the culture from one focused on tasks to customers and revenues is still evolving, but much improved.

Brand and Image of the Bank

A major obstacle was taking on the existing perception of the Bank. Although there were many institutional advantages, the Bank still suffered from being seen as a politically driven organization. The first approach was to provide valuable products and services to the customers as soon as possible. The 1 percent withdrawal fee was immediately dropped (which was a major impediment to bank usage) and rates on time deposits were raised to the top of the market, quickly giving the Bank the liquidity it needed.

A major public relations campaign was launched very early on telling Mongolia that the Bank was serious about business and be open to all. As well, early on the Bank went through a rebranding by switching the name to an acronym "XAAH." This translates to khan or king, a name with strong local appeal because of Genghis Khan. Television and radios campaigns soon followed.

RECOMMENDATIONS—LESSONS LEARNED

Certainly it is challenging to turnaround a large state-owned bank. Success rests on a confluence of political and financial circumstances, both internal and external factors. Various lessons learned and pre-conditions are summarized below:

- **Market demand.** There must be access to an underserved market with untapped demand sufficient to support the restructured bank. If the prospective market is being adequately served by others, the cost and effort of a turnaround is probably not justified, and could crowd out existing financial institutions. General studies were made to understand the general market potential before the turnaround contract began. The fact that a strong informal market was offering loan rates of 12 to 15 percent a month showed a demand that banks were not serving.

- **Protection from political influence.** A critical part of the turnaround was getting assurances from the government that the new management team could operate free from political influence. The new management team was given the authority over personnel issues, credit policies, expenditures, etc. through a memorandum of understanding.

- **Government commitment to privatization.** Although the outside management has the authority and responsibility to run the Bank, the problem could arise when they leave, when the "firewall" comes down. This is why it is so critical that one of the pre-conditions previously discussed is held to. That is, that the government has to commit to the privatization of the Bank. It has to agree to turn over the institution to private hands that will have private investors in which to be accountable. Thus, a management contract should run until privatization, maybe three to four years.

- **Market research.** The Ag Bank retained a very good local firm, Sant Maral Foundation, to do a longitudinal study of Mongolians' attitudes in general and to the Ag Bank in general. This provided valuable information when preparing the products for the market and to measure the impact of the changes in the market.

- **Capitalize on the strengths of the staff.** One of the clear advantages at Ag Bank was a well trained and disciplined staff. While they were not used to thinking strategically, they quickly grasped new products and marketing approaches and implemented them. In the countryside the staff and their families are imbedded in the local communities, and they know who and where and how to find people to borrow money who would pay it back.

- **Develop a strong internal staff culture and external public image.** State-owned banks often have negative public images. It is important to capitalize on the existing positive aspects of the brand, but the institution also needs to be seen as "new and improved" from both a customer and employee perspective. Ag Bank had a particularly unfavorable reputation in the eyes of the public but was trusted for its implicit government backing. Through efforts to develop brand identities, better customer service and overall public confidence, Ag Bank now commands much more favorable opinions. Staff buy-in is critical to the success of the institution. Within the Bank, motivating the staff through training, fair and performance-based compensation, and recognition for good work has created better and more efficient working environments.

- **Foreign management was important.** As an expatriate on a management team, operating under a clear sense of corporate governance and of protecting Ag Bank's assets, there is a clear power and authority to say "no." Foreign managers focused on the Bank's turnaround didn't have the societal imperatives that create expectations. Therefore, it was critical that the new top managers come from outside of Mongolia if there was to be a rapid turnaround.

- **Diversification away from government reliance.** At the beginning, more than 50 percent of the deposits were from the government. This reliance put Ag Bank's liquidity position at potential risk if the government were to withdraw significant funds. The Bank sought and attracted deposits from private businesses and individuals. The result has been a shift from 52 percent government deposits to the current 86 percent. The private sector deposits are made up of hundreds of thousands of individual depositors thus also creating greater diversification.

- **Control local political risk.** Taking control of the decision process did not end at the ministry level. Previously, the local branches functioned as part of the province or county administration. The branch managers were appointed in most cases by the local governors of the ruling parties. A branch manager was a source of jobs and loans for people who desperately needed them. Based on the culture, they were more likely to first accommodate the need than to understand the implications from a business perspective. Managers now understand the importance that the institution be strong, thus creating more outreach to even more viable clients, thus stimulating the overall economy. They also know that the management team is holding them accountable for their actions. They know that if they perform well, they will be compensated fairly and receive proper incentives and bonuses for performance.

  The foreign managers need to recognize that the national staff will need 'protection' from local pressures, as they will become the next logical targets. The key is to have clear policies that require transparency and people who will speak-up when they are asked to break them and will use the foreign managers as a way not to comply with inappropriate requests. The first encounter with an official who wants his way and can't get it can be difficult, but when people know that this new management operates transparently, they usually don't ask for favors or bribes.

- **Donor support.** Although a turnaround is conceptually feasible without international support, the turnaround in Mongolia would not have occurred without participation by the World Bank and USAID. Other bilateral and multilateral entities also made significant contributions. International donors helped ensure the decision-making authority of the turnaround teams, and provided critically needed funds for capital improvements and technical assistance. The World Bank was instrumental in reaching consensus with the Mongolian government, while USAID funded the DAI team that led Ag Bank's turnaround.

- **Determining the beginning balance sheet.** Before beginning an assignment, the turnaround team must understand the true position of the Bank's balance sheet and negotiate accordingly with the government. All earning and fixed assets must be properly evaluated and any needed capital must be put into the institution to raise the capital base to no less than zero. Capital can be injected as cash or as development bonds, depending on the institution's liquidity position. If bonds, the interest should be paid in cash to provide adequate cash flow. There should be adequate funds to cover initial operating costs and to purchase immediately required fixed assets. A long-term cash flow stream needs to be identified to support the ongoing operations.

- **Central Bank guidelines.** The turnaround team should also reach agreement with the Central Bank as to when the Bank's financial ratios should comply with prudential standards. A conservative timetable should be put in place. Internal targets for achieving certain operational and financial objectives should also be made. The Ag Bank now meets all Central Bank guidelines.

- **Training.** In the two and half years of the USAID funded remediation, training has been an integral part of reform for staff at all levels. This has been nearly all focused on practical skills and information needed to deliver the Bank's products and specific skills employees needed to perform their jobs. Because of the importance training played in making the turn around of Ag Bank possible, GTZ provided assistance to establish a professional training department at the Bank, and significantly improve the individual trainers' skills.

- **Understanding costs.** If faced with challenging financial targets, the first reaction of many new managers is to start by cutting costs. A common problem at state owned banks, however, is that not enough is being spent to generate required revenues. There are costs associated with delivering products and offering an acceptable level of customer service, which is critical in a competitive market. It was found that small additional expenditures at the initial 269 Ag Bank points of service could lead to exponential growth in revenues. With only $300 profit from each small office and the contributions from larger regional centers, it was not long before $300,000 was being earned each month. These numbers were substantial for a Bank without capital and with initial assets of only $10 million, but quite achievable.

- **Cut unnecessary expenses.** However, to generate the profitability, the increase in revenues needed to be met with the cutting of unnecessary expenses. For example, while new staff was brought in as part of improving the services or technical aspects of the Bank, other staff had to be cut based on competency levels and redundancies. In the case of Ag Bank, most of these cuts took place while the Bank was under Central Bank receivers. Focusing on cutting the right costs was one of the first steps that the new management took.

- **Maintain low operating costs.** State-owned banks can usually meet the needs of their market segment with relatively low-cost operations. The intent is not to compete with international banks going after high-end customers, but to appropriately serve the rural and low-income market segments. Money should be spent to make the branches adequate and comfortable, but they don't have to be the best in town. Occasionally, only two persons are needed in a location and technology beyond hand ledgers and a calculator may be quite adequate.

- **Finding the golden goose.** Every project needs a golden goose, a competitive advantage. In the case of Ag Bank, a real need for sustainable financial services existed in the rural areas of the country. The Bank was able to leverage existing branches and staff to deliver services quickly and efficiently.

- **Management.** As is important in running any business, the skill sets and competency of the senior management were critical. The team brought together experiences, knowledge and management skills from working in countries with similar economic situations as well as a strong knowledge and experiences from U.S. banking. In addition, an executive team of some of the best Mongolians were recruited and have clearly provided very important technical and cultural knowledge that have been part of the transformation of the Bank.

  Management must feature clear lines of authority and be the joint effort of expatriate and local professionals. The starting point of Ag Bank's turnaround was precarious. Decisions had to be reached and implemented quickly, it was critical to deploy individuals with relevant outside experience, who were not beholden to domestic political interests. Local departmental managers hired or promoted to the executive level were highly valued for their institutional memories, as well as their keen understanding of the domestic market and culture. The project could not have been successful without synergy between outside and inside management.

- **Meet the needs, have an impact.** Often, small businesses will borrow lower amounts of money than they need, which can be valuable in building a borrowing history. However, if the lending products do not adequately meet the needs of the business and match their ability to service certain levels of debt, a large dropout rate will occur. Thus, the products (including the delivery and services attached to it) must grow and develop to reflect accurately the needs of the market. The most expensive part of a borrower relationship is acquisition—bringing the borrower into the institution for the first time. Profitability and sustainability will come from loan renewals and cross-selling other products.

- **Management information systems.** One of the most common reasons why any business fails is uncontrolled growth. In a state-owned bank turnaround, it is imperative that revenue growth be balanced by a quality portfolio and by systems and procedures to detect and correct problems. Systems to monitor portfolio performance and to detect fraud are both crucially important. These systems do not have to be complex—at remote branches, they need not always be computerized—but they must be timely and complete.

CONCLUSION

Management was able to pursue successful turnaround strategies at Ag Bank because of the remediation's unique design and the support of the Bank's stakeholders. As the historic state-owned bank in the countryside, Ag Bank was under very strong pressure to serve the government's political needs. Because the USAID funded project team was given full authority for the Bank, a unique approach for USAID, a new credit and operating culture could develop which has resulted in a very profitable and high quality credit portfolio. The carefully structured independence, buttressed with donor conditionalities, was essential to rebuilding a sound bank.

A key lesson learned by Ag Bank is the importance of marketing: focused research, strong brand promotion, and products responsive to customer demand to provide an income stream to sustain the organization. Ag Bank's managers used a combination of local knowledge from their branch managers, formal market surveys, and experience from working in other developing countries.

Some doubt whether low-income populations are willing and able to pay for the financial products and services they need, but the experience in Mongolia proved different. Where per capita incomes are low, the experience has proven that there is a large market for the right kind of deposit and credit products, even if the interest rates and fees are relatively high. Low-income market segments will pay for the right products and good service.

With a low operating cost basis and good returns from lending, the Bank was able to generate the profits to reinvest in physical and human infrastructure, and make the Bank sustainable, while providing the needed services to the underserved market. The process evolved into a "virtuous cycle" driven by the strong demand, as well as need, for the new services.

Also, the Ag Bank experience stands in contrast to the commonly held view that state-owned "dinosaur" banks cannot be turned around and successfully privatized. There may be other cases where, despite a poor history and state sector culture, latent but strong franchise value in a branch network or customer flow can be capitalized into profits and sustainability.